AFG working document

Response to the consultation on Capital Markets Union

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Document in progress

Executive summary – AFG response to the consultation on CMU

The French Asset Management Association (AFG) would like to thank the European Commission (EC) for launching this public consultation on a future *Capital Markets Union* (CMU). AFG clearly supports the principle of such a Union and encourages its efficient implementation, closely associating all European participants to public and private investments and preserving the plurality of existing European ecosystems.

It has to be noted that the accumulation of "punitive" European texts over the last few years, though many of them were indeed necessary to fill under-regulated areas, did not reach its objective to revive growth; on the contrary, in some respect it even induced anxiety. Raising the breakeven point of players because of the additional costs implied, these texts reduce innovation as they curb creation and the development of new structures. Going forward the principle of proportionality should be further developed.

The future CMU thus represents a strong opportunity not only to go towards a Europe fostering more investment, but also to substantially improve several earlier texts whose implementation on the basis of delegated acts raises significant issues, some of them directly impacting the attractiveness and competitiveness of European financial places.

In the context of the CMU, asset management should be in a position going forward to strongly increase its role - already essential - of financing the European economy in the short, medium and above all long term. Such a **strategic** function is even more essential that bank financing will not be able going forward to play a role as important as in the past.

AFG responses to the questions asked in the consultation, as well as other more exploratory reflections on which we would like to raise the EC's attention, at the end of our paper, articulate around the following few main orientations:

- The project of CMU, as well as its two complementary consultations, and more generally the legislative and regulatory initiatives that the EC may formulate during its mandate, should all lead to **strongly encouraging the financing of the economy through (perfectible) short, medium and long term investment tools**. This will be for the EU proof of its credibility and consistency, very much needed by economic players.

  Among long term investment tools should absolutely be included incentive mechanisms for the creation and the development of retirement savings schemes capable of bringing responses to the funding of retirement pensions and of offering an adequate framework meeting the needs of EU citizens who wish to save for retirement and of employees who, more and more often, will lead their professional career successively in different Member States.

- An effort of training and education of savers/investors coordinated at European level will have to be rolled out. It will have to aim at developing confidence, showing that channelling savings to the financing of the economy is a win-win scheme, and not mainly relying - as it has been the case until now – on the "promotion" of the coercive regulatory measures adopted over the last decade.

- The diversity of European financial places will have to be not only preserved but also developed.

- **The harmonisation of distribution rules and the removal of impediments to the "passporting" of funds** imperatively have to be scrutinized, in order to improve accessibility, transparency and security for savers/investors.

- Through the facilitation of the development of tools that already exist, first and foremost, but not limited to, the ELTIFs, the CMU will have to result in **encouraging savers to finance companies**, **first and foremost innovative European SMEs** and infrastructures.

- The question should be raised of the **competences of the European supervisory authorities** (ESAs) and of their actual powers, as well as of sanction mechanisms. More generally, the issue of the articulation of the legislative and so called "level 2" texts should be clearly resolved. **The uniform application of rules at European level**, required for an efficient level playing field, directly depends on it.

- At international level, the **principle of reciprocity** should be further promoted and defended, including with the use of more offensive lobbying strategies and particularly in the negotiations that are currently open.

- Last, in spite of their historically complex integration in the European institutional framework, **tax incentives should remain a key ambition** that should be pursued in order to allow a full achievement of the CMU. They will have to cease discriminating in favour of debt against own capital and of governments against private companies.

AFG would also like to highlight, in the context of this consultation, the importance of restoring **consistency between, on the one hand, the ambitions stated by the EC regarding the efficient financing of the economy and, on the other hand, a series of European texts that unfortunately produced or will produce completely contradictory impacts**.

Let's in particular note:

1/ the MIFID II and Solvency II texts which, de facto, put long term and risky investment at disadvantage and divert private investors from supporting European SMEs;

2/ the EFTT which would produce extremely negative impacts on European competitiveness;

3/ the so called "Shareholder Rights" Directive that in practice provides for highly excessive requirements, which could potentially discourage investment in equities ;

4/ the state aid regime, in particular the regime applying to SMEs, the General Block Exemption Regulation defining European SMEs too strictly.

Last, AFG recommends that reflections on several new topics should be initiated, including:

- The creation of a true *European label for financial vehicles* (regardless of their country of origin), starting with regulated products such as UCITS;
- The creation of European company and individual retirement savings schemes (please see below);
- The creation at European level of a consolidated tape, required to allow investors a clear and exhaustive view of purchase and sale orders of financial instruments negotiated on several markets (including non regulated markets).

One of the main priorities is to restore confidence in financial markets. Without investor confidence, no project aiming at channelling savings to investments will be successful. Such a confidence may be asserted in maintaining a high level of responsibility with respect to governance and responsible investment.

1) Beyond the five priority areas identified for short term action, what other areas should be prioritised?

The prospect of building a CMU is an excellent initiative. However, AFG is concerned by several imminent European decisions which would be inconsistent with this aim.

1. Indeed, the first priority should be, according to AFG, to ensure consistency between regulatory requirements (recent or in progress) and the objectives announced by the EC in the context of the CMU and the Juncker Plan. In order to reach the prime objective of restoring confidence :

A. Regulatory projects which are contradictory with the CMU and the Juncker Plan should be dropped: the European Financial Transaction Tax (EFTT) would inevitably and very distressingly imply, on the basis of a reinforced cooperation among eleven Member States only, a fragmentation of capital markets and, on a European-wide basis, a diversion of capital away from the EU and in favour of geographical zones which do not penalize investment as heavily.

B. An appropriate calibration of the texts under negotiation at level 1 and 2 should be ensured

At level 1

We hope for a better calibration of the texts under negotiation, in particular the Regulation proposal on money market funds. In the context of the negotiations currently taking place at the European Parliament and at the Council, AFG is worried about the definitions of eligible assets and liquidity ratios that have been discussed so far, which would mobilize a large part of the amounts investable in the real economy. Last, we wish to raise the EC's attention on the fact that the creation of "government MMFs", invested to over 90% in government securities and treated more favourably than other MMFs, would inescapably generate a foreclosure effect detrimental to the short term financing of companies.

Furthermore, in the context of the structural banking reform, the prohibition for banks to provide seed money to alternative investment funds (AIFs) would be, if confirmed, a real threat for the European alternative asset management, now regulated by the AIFM Directive. Without any seed money the alternative asset management could not exist. To be competitive, it should be allowed at least in the same limits as those that apply to our American competitors (please refer to the Volcker Rule).

At level 2

We would like to raise the EC's attention on the fact that the third country passport for AIFs would result in draining part of European savings into non European vehicles, which will not make the European economy benefit from a domestic bias, but on the contrary will benefit to the domestic bias of geographical zones or countries where these vehicles are managed. This is even more crucial that access by savers in the relevant countries (in particular American) to European AIF is not at all ensured.

Last, if the EC decided to follow ESMA's advice (MIFID II level 2) on the funding of financial research, such new restrictions would considerably increase the cost and at the same time considerably reduce the amount of research on SMEs/mid cap companies. Indeed, access to market finance by SMEs/mid caps will only be possible at the express condition that investors can have sufficient information and research on companies and on a continuous basis.

In general, we note that the implementation of the provisions relating to reporting in MIFID II and PRIIPs, as they set an excessively strict framework (e.g. exhaustive disclosure of fees in Euros), is likely to have a dissuasive impact on distribution channels and lead them to discourage placement or investment services resorting to financial instruments and to direct savings to products which are not regulated under MIFID II or which require neither advice nor a reporting which is difficult to implement. If it was confirmed, such an approach would have very negative impacts on long term investment. MIFID II should be aligned on the future IMD II.

C. The regulation on state aids should be reviewed: it should in particular be clearly established that tax regimes favourable to investments in European SMEs, which do not impact trade among Member States, are not considered as state aids.

Furthermore, AFG recommends increasing the ceiling of 15 million Euros used in the definition of SMEs and the limit of 7 years of existence that allow SMEs to benefit from a state aid. The current regime is too strict and deprives SMEs from a support crucial at their development stage.

2. The second priority is to ensure a level playing field.

- Appropriate conditions for a fair competition within the EU should be created. We expect in this respect that the ESAs ensure a better harmonisation of the implementation of the rules within the EU.

- Furthermore, in order to preserve, or even to restore, the competitiveness of European financial places, we call on the EC to work more closely with international financial regulatory bodies (FSB, IOSCO), to act with them in a more coordinated way and to ensure that the relevant international standards are applied in a harmonised fashion.

- Last, the CMU should aim at establishing a level playing field among savings products/ contracts/investments/placements. Divergences between MIFID II and other Directives are in this respect very damaging. An alignment of MIFID II on the future IMD II should thus be aimed at. In the same way, the existence in some countries of remuneration rates on administered savings and/or government guarantees on certain products result for instance in individual investors being deprived of profitable savings products which help financing the economy, without providing savers with adequate returns.

3. Third priority, conditions allowing the channelling of savings (in and out the EU) to investment products should be created.

a) A significant global pedagogical effort is and will be required. The training of savers/investors will have to be developed in all EU countries.

b) **AFG calls on the EC to remove obstacles to company savings schemes in the EU**. The so-called "employee savings" schemes are today hindered by some countries, such as Germany and the

Netherlands, for the reason that they rely on AIFs. A level 3 measure by ESMA would be welcome to clear any ambiguity and to allow their distribution within the EU.

AFG also invites the EC to examine the current legal framework that prevents the creation of trans-European "employee savings funds". **It would be useful to create a vehicle dedicated to "employee savings funds" and in particular of employee shareholder funds which could be distributed within European companies**. Such a reform could take place in the context of the revision of the AIFMD (scheduled in 2017) or through the creation of a specific vehicle.

c) **AFG supports the creation of European retirement savings products** which is not only required to supplement public regimes that all European citizens benefit from but also likely to help the development of long term savings in Europe. The European Commission should refrain from taking initiatives unfavourable to existing retirement schemes (in particular though the IORP II proposal). It also should take all possible action to prevent member states from raiding existing funded schemes (2nd and 3rd pillar) as it has been unfortunately the case in Western and Central Europe last few years.

d) AFG welcomes the new lines of approach and new vehicles identified by the EU to launch the CMU and to channel savings to players that need them i.e. **securitisation and the revision of the Prospectus Directive**. Regarding the revision of the Prospectus Directive, we call on the EC to find a right balance, allowing a reduction of the costs implied by the elaboration of a prospectus while preserving an appropriate level of information useful to investor decision making. Furthermore, if the current requirements of the Prospectus Directive were to be reduced, we wish to raise the EC's attention on the need to ensure a level playing field and to provide for a regime at least as favourable for products that are not covered by the Prospectus Directive i.e. the UCITS and AIFs.

e) **AFG encourages the European institutions to facilitate the implementation of ELTIFs** through an adequate calibration of the level 2 measures, an appropriate treatment in Solvency II and the support of the principle of a tax regime favourable to investors in that new type of vehicle. European institutions should encourage Member States to themselves put in place <u>incentivizing regimes</u>, providing investors with the best regulatory and fiscal benefits in the relevant countries.

f) AFG encourages the EC to promote the use of tools which allow economies of scale (umbrella funds, master feeder structures, share classes).

g) Last, AFG wishes that the EC commits to **removing barriers to the exportation of European funds through trade negotiations** with our partners (China, Brazil, US).

<u>2) What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?</u>

a) **In order not to further limit the - already insufficient - information on SMEs available to investors, AFG invites the EC to apply extreme caution regarding the MIFID II delegated acts, and more particularly the section on the remuneration of financial research**.

Indeed, when proposing to make the financing procedures of external financial research more complex on the one hand and prohibiting that these charges are mutualised among large capitalizations and small/mid capitalizations on the other hand, ESMA turns MIFID II into a hindrance to financial research on small and mid sized companies.

Such new restrictions would considerably increase the cost and consequently reduce the offer of research on SMEs/mid cap companies. Indeed, as of today, the situation already is unsatisfactory as, for example, 50% of small and mid sized companies listed on Euronext[1] do not benefit from any financial research and 16% only have one analyst. Let's recall here that in France 50% of assets under management invested in small and mid sized companies are managed by small and mid sized asset management companies, which would be particularly impacted by the increase in functioning costs implied by ESMA's project. We therefore strongly call on the EC not to follow ESMA's advice on this point.

b) **AFG notes that only a small number of regulators put in place databases on the solvency of SMEs. The European institutions should encourage all other regulators to put in place similar databases and to examine the possibility of them use in conditions that would preserve the confidential nature of the data on SMEs and without regulators being considered as credit rating agencies.**

c) **AFG is concerned by the limited number of financial data providers. Moreover, such data is sold at increasing prices and disproportionately to its nature. In order to complete the CMU, it seems crucial that reliable and comprehensive data should be available to all players.**

d) **In the same way, AFG calls for the creation of a "consolidated tape" at European level, so that information on key market parameters allow the relevant players to place themselves in appropriate conditions in terms of transparency, efficiency and cost.**

<u>3) What support can be given to ELTIFs to encourage their take up?</u>

The European institutions should strongly recommend that investors in **ELTIFs benefit in each country of the most favoured investment clause, both from a regulatory and a fiscal point of view. The treatment of ELTIFs and other long term investments under Solvency II will be key to their success. Guidelines could be published to this aim**.

The EC should promote, for ELTIFs and other long term investment vehicles, the coordinated use of different means or devices used in the Union, as long as they aim at promoting or developing long term investment; for example, the labelling, or even the guarantee, of certain projects by the EIB could helpfully benefit the vehicles that would decide to invest in them.

A reflection should also be carried out on the eligibility of ELTIFs to the "free" 10% ratio and to the 30% eligibility ratio of UCITS and AIFs.

<u>4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?</u>

AFG welcomes the fact that market participants are taking the lead on this issue and are developing their own tools aiming at supporting and developing European private placement markets (the *Pan-European Corporate Private Placement Market Guide* is an example that illustrates the merits of such a non "regulatory" approach). It supports such initiatives.

[1] *SMEs with a capitalization under 1billion Euros and listed in Paris, Brussels, Amsterdam and Lisbon, source: Euronext*

Going forward, an intervention by the European authorities will prove useful only if the development of such initiatives encountered obstacles that could only be removed through legislative action, which at this stage does not seem to be the case.

5) What further measures could help to increase access to funding and channelling of funds to those who need them?

a) In order to better channel funds to those who need them, the EU should also **ensure that the regulatory framework does not favour government or public entities' securities** to the detriment of corporate securities. A recent counter-example – which adds to other earlier cases e.g. collateral management, Solvency II - is the proposal to create a "government MMF", investing over 90% in government securities and benefiting from a treatment more favourable than other MMFs, which would inescapably generate a foreclosure effect detrimental to the short term financing of companies.

b) In line with this, it would be relevant to **recalibrate the capital requirements defined under Solvency II and CRR/CDR IV** and in particular those associated to investments/vehicles that participate to the objectives of the CMU (and if relevant of the Juncker Plan), such as investments in equities, listed or not, in securitised assets or in infrastructure projects in a broad sense (e.g. real estate, transport infrastructures). For example, in the context of Solvency, AFG supports the review of capital requirements relating to investment in commercial real estate (25%) which had been set with reference to the most volatile real estate market data in the EU, i.e. that of the UK. An assessment of Solvency II by an independent research organisation, using data representative of the volatility of the European market, clearly shows that going forward it would be unreasonable to impose capital requirements over 15%.

AFG responded along these lines to EIOPA's consultation on infrastructure investments by insurers.

c) **The further development of the Small Business Act for Europe (SBA), adopted in June 2008, could prove a very efficient tool in terms of financing and growth for SMEs**. Even though the SBA reflects the political will of the Commission to recognise the central role of SMEs in the EU economy, it is limited to a series of principles and recommendations. Contrary to the American SBA of 1953, SBA for Europe is not operational in at least one closely related area and which should be developed i.e. **the facilitation of access to public markets thanks to a percentage of public orders reserved to local (i.e. European) SMEs**, which promotes local innovation as well as allows small players to compete with large companies so that they can also reach an international size.

d) In line with the objectives of the CMU, it would be relevant to **achieve a regime of "state aid" rules more flexible in terms of financing of innovative SMEs** (such as the FinTech referred to in question 31) as well as of companies at start up and development stages. In particular, it should be clearly established that tax regimes promoting investments in European SMEs, which do not impact trade among Member States, as well as those that do not discriminate companies depending on their nationalities, should not be considered as state aids. Furthermore, AFG recommends increasing the ceiling of 15 million Euros used in the definition of SMEs and the limit of 7 years of existence that allow SMEs to benefit from a state aid. The current regime is too strict and deprives SMEs from a crucial support at their development/exportation stage.

e) A tax regime providing incentives to individuals willing to invest, directly and through investment funds, in companies, in particular in SMEs/small caps, remains the most efficient tool

to channel funds to those who need them. The European institutions should issue clear guidelines in this respect and obviously refrain from creating additional constraints (e.g. EFTT).

<u>6) Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?</u>

The liquidity in corporate bond markets may indeed be an issue and, as for financial markets as a whole, the existing regulatory framework (MIFID I) played a negative role, as in reality it encouraged an excessive fragmentation. The Commission should absolutely make sure that the level 2 measures under MIFID II improve this situation.

Furthermore, by construction, these bonds are not designed to necessarily be traded on a market: they can simply make do with an arranger. Also, the efficiency of platforms has not been proven yet, in particular due to a poor "after sale service" i.e. the absence of a liquidity contract over the long run. This point would be worth further examination, but it is not obvious at first sight that regulation could solve these shortcomings. On the other hand, **if the funding of financial research was questioned as well for bonds, if the EFTT also covered bond transactions, and if the structural banking reform set a restrictive definition of the activity of market making or required its transfer to a subsidiary, the future regulatory framework would be likely to have a negative impact on this liquidity**.

<u>7) Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?</u>

a) **With a view to support their approach of socially responsible investment, European institutional investors could be encouraged to disclose in their investment policy their taking into account - or not - of environmental, social and governance criteria**. Bearing in mind that this would not in any case be a requirement for investors to invest according to ESG criteria but simply to ask them to disclose whether they do it or not.

b) **The search for, then the promotion of, a common definition of Socially Responsible Investment (SRI) would allow bringing closer together the practices of the different Member States and facilitating the development of investments based on environmental, social and governance criteria.**

For example, the definition set by the French market is: « *SRI : Investment that aims at reconciling economic performance and social and environmental impact by financing companies and public entities which contribute to a sustainable development regardless of their sector of activity. By influencing the governance and the behaviour of players, SRI promotes a responsible economy*".

c) **In order to promote ESG investments, a reflection on a European label** for funds and other investment products which meet these criteria could be launched.

d) **Regarding green bonds or more generally sustainable bonds, it seems important to put in place good practices on the transparency of the allocation of the funds raised**, on the review of their ESG risks and on their reporting, in order to reduce the risk of “green washing”. AFG has recently published a guide on this subject.

e) Projects aiming at eligibility under the Juncker Plan could be encouraged to disclose their ESG commitment.

8) Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

It should be ensured, through a cost benefit analysis, that the establishment of such standards would actually contribute to increasing the attractiveness of SMEs and to better information of European investors.

9) Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

Crowdfunding can foster the creation of companies and contribute to their development. It is however crucial that it is governed by practices harmonised among Member States.

Regarding the issues of and barriers to the development of these platforms, AFG would like to insist on the importance of ensuring investor protection (for both loans and capital contributions). The quality of information provided to European citizens should be certified. AFG wishes to highlight the reputational risk that could arise from the bad practice of some players and that could potentially tarnish all players involved in the financing of SMEs. Investors should in particular be confident that their investment is entirely used to finance the beneficiary entities. Their crowdfunding investments should be limited to a certain part of their wealth and/or their annual income.

Generally speaking, the European Union should overcome the paradox existing between promoting crowdfunding (very risky by definition) and the addition of ever more restrictive measures (e.g. PRIIPs, MIFID II) in the context of the placement of regulated products that have proven themselves such as UCITS or now AIFs.

10) What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

a) **The regulations** applying to institutional investors which require a systematic use of a **mark-to-market valuation should be reviewed**, as they are not appropriate to long term and/or limited liquidity investments.

b) Furthermore, institutional investors are very sensitive to the different types of liquidity on offer depending on the relevant liabilities. Thus, even over the long term, **liquidity rules** should not be imposed but rather left to the responsibility of investors.

c) More generally, it should be ensured that **regulatory investment ratios** applying to institutional investors are appropriate to the types of investments recognised in the context of the CMU.

<u>11) What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?</u>

a) The **AIFM** and **UCITS** Directives allowed the introduction of **passports** relating to products or to the possibility of performing an activity in another Member State. Those devices may be **impeded by the erection of more or less implicit barriers, sometimes merely administrative, by host Member States** (e.g. excessive fees or taxes to be paid to the host regulator, documents required additional to the obligations of the directives). These practices, which tend to reduce the reality of the freedom to provide services or to distribute products throughout Europe, should be opposed.

b) S**ecurities settlement systems on domestic markets should also be simplified and harmonised**. Today, each country has its own national system which makes the distribution of foreign funds difficult.

c) **Furthermore, tools for obtaining economies of scale do exist (umbrella funds, master feeder structures, share classes). Unfortunately, the implementation of such tools is sometimes very difficult** (cross border master feeder structures) or subject to interpretations which are very different and even often restrictive from one country to another (share classes). As a result, these tools are, at least in some countries, under-utilized. Therefore, we positively welcome ESMA's consultation on share classes with a view to allow the harmonized development of such a scheme, which can potentially achieve significant economies of scale.

d) Last, it seems totally unjustified that, contrary to the text and the spirit of the Directive, Luxembourg requires the creation of a local management company for the creation of an AIF domiciled in Luxembourg (denial of the "asset management passport"). Such a practice clearly is against any economies of scale.

<u>12) Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?</u>

The definition of infrastructures should cover all types of projects without discarding a priori any sub-class of assets. Developing the existing regulation exclusively in favour of investment models in "historical" infrastructure asset classes, which indeed are well known and benefit from tested frameworks, and offering them the benefit of a "with no risk" label could go against the development issues currently at hand. Looking at an infrastructure asset class globally is key to allow and foster not only the renewal of existing infrastructures but also investment in infrastructures that will underpin tomorrow's growth, in particular in the energy sector (production, distribution, storage, energetic efficiency…), telecommunications (fibre network, towers, data storage), transportation (airports, ports…). **Regulation, whose development is a long term process that can last over several years, should provide a flexible framework defining common criteria for infrastructures and not existing sub-classes of assets with a long track record which would result in discriminating against more innovative projects for the future having nonetheless characteristics similar to existing assets.**

Infrastructure financing should be fostered, whether it is achieved through loans or capital contributions. In order to assess the risk attached to each project, it is important to organise a collection of data in order to make a relevant benchmarking and to focus on a definition of an infrastructure asset class shared at European level.

Furthermore, prudential rules should indeed be reviewed; however, they should not be limited to insurance companies and banks; the possibilities for retirement savings schemes or other investors (mutual insurance companies for example) to invest in infrastructures should be made more flexible.

Last, in the context of the Juncker Plan, a list ("pipeline") of eligible projects should be made, regularly updated and publicly disclosed.

13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

With regards to retirement, the EC's main objective should be to encourage European citizens to save in order to supplement compulsory regimes, through company and individual schemes.

Population ageing results in imbalances of the pay-as-you-go systems in all Member States; therefore funded schemes should be enhanced. This is a win-win measure as the long term horizon of retirement savings allows investing and financing economic growth. For this reason, any initiative in favour of retirement savings is welcome. Given the long term horizon, confidence in the relevant savings product is a key element.

Company retirement savings schemes (2nd pillar) should be strongly promoted as the professional environment and the engagement of social partners tend by nature to reassure future retirees. Companies should not be discouraged to put them in place by the application of increasing constraints and inadequate prudential regulations – such as Solvency II. Going forward, an increasing number of Europeans will perform at least part of their professional career in Member States different from their Member State of origin. Within European pension funds, whose framework is to be defined as a priority, an efficient portability of pension rights will not only be necessary but will also improve the occupational mobility within Europe that the Commission and the Member States call for.

Individual retirement savings (3rd pillar), outside the professional environment, should also be encouraged, in particular for those who do not benefit from company retirement savings plans (independent workers, the unemployed…) or for those who wish to make an additional savings effort.

AFG therefore recommends that European retirement savings products, necessary for the development of long term savings in Europe, may be introduced. In order to avoid incompatibilities with existing national legislations, AFG would welcome the creation of a "29th regime" with an occupational and an individual component.

According to AFG, a retirement savings product should be both secure and flexible in order to be attractive to European citizens, and in particular:

- be designed so that it can be **managed by different regulated financial players**: asset managers, banks, insurers;

- have **distribution rules that are simple, secure and consistent** (these rules are today different depending on the category the financial player belongs to: MIFID, IMD);
- offer **a choice of investment options** in order to accommodate the different profiles of subscribers and offer by default a "lifecycle" option in order to reduce the risk as retirement approaches;
- offer **a choice of exit options** at the time of retirement (and potentially of the purchase of a main residence) so that the person may choose the solution best suited to his or her personal situation: partial withdrawals, full withdrawal, annuities, mixed solution…

14) Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?

As France and most of Member States have not introduced – at least as of today – legal vehicles specific to these Regulations, asset managers must use vehicles existing in their country which involve additional constraints that are not included in the Regulations. The European Union should further encourage Member States to introduce such vehicles so that national and European obligations do not double up.

The possibility for asset managers whose assets under management are above 500 million Euros to manage EuSEFs or EuVECAs could enlarge the number of players and would be warmly welcomed. ESMA, in a Q&A on EuSEFs and EuVECAs updated in November 2014, introduced the possibility for AIFM asset management companies above the 500 million threshold to manage EuSEFs and EuVECAs. However, ESMA's advice is not in our view consistent with the level 1 text and AFG calls for a required legal clarification.

15) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

The recent reform of the guidelines on risk financing and of the Group Exemption Regulation does not meet the needs of financing of SMEs. **The EC's approach on state aids with regards to SME financing should be thoroughly modified**. Fiscal regimes that promote SME financing should no longer be considered as state aids when they contribute to the financing of all European SMEs and not only SMEs in one particular Member State.

The European Union should facilitate investment by institutional - and even retail - investors in non listed entities while introducing appropriate protection rules. For institutionals, this would consist of removing prohibitions to invest in non listed entities. Today, many institutional investors are very restricted in their investments in non listed entities because of European regulations that are ill designed such as CRR/CDR IV or Solvency II.

Furthermore, UCITS may not invest in capital investment funds, even under their "free" ratio: such a prohibition has to be removed.

16) Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

It would be contradictory to on the one hand encourage investors to make direct lending, which is very risky and not much regulated, and on the other hand to require, under PRIIPs and MIFID II in particular, an excessively high level of investor protection in the context of products that are already well regulated (e.g. UCITS).

Regarding non bank lending, there is a real risk of asymmetrical information. It is important to facilitate access to information on companies. Extreme caution must however be applied to soliciting tools used vis-à-vis investors. Particular attention should be paid to this point, including with regards to crowdfunding.

17) How can cross border retail participation in UCITS be increased?

The cross border distribution of funds in the Union often remains penalised by the introduction of local tax regimes that are difficult to implement (withholding tax systems).

Even though regimes for setting up and running funds are fairly largely harmonised, quite noticeable differences remain, in particular regarding procedures of modification of UCITS, which may involve implementing mechanisms relating to investor information that are different, and therefore very burdensome, even discriminatory depending on the State where investors live in.

The introduction of "European retirement savings" products is a line of approach supported by AFG. By raising the share of long term savings held by individuals, it will allow increasing the cross border participation of individual investors in UCITS, which are its natural underlyings (please refer to questions 13 and 19).

Also, AFG is favourable to tackle impediments to the efficient implementation of the UCITS passport, which may be based on the application of national measures in the area of distribution, taxation or information.

18) How can the ESAs further contribute to ensuring consumer and investor protection?

a) **In spite of the ESAs' guidelines, the implementation of financial services legislation is still far from sufficiently harmonised within the EU**. In the context of the EU internal market, investors and asset management companies are indeed faced with rules that are implemented differently from one Member State to another, due in particular to diverging interpretations and differing approaches among national regulators: translation issues, gold plating or, on the contrary, minimalist interpretation of the rules.

Investor protection is partly ensured by local regulators in addition to legal structures specific to each country. In the spirit of the 4th level of the Lamfalussy procedure, the sanctioning and controlling power granted to regulators should ensure the effective implementation of these controls by local regulators and address any default.

b) **The ESAs should also be granted the possibility to address issues regarding the linguistic interpretation of level 1 texts**, for instance in order to remove any regulatory arbitrage opportunities among Member States, which are in particular to the detriment of the protection of investors (e.g. UCITS IV – 30% eligible assets ratio: “asset division” in French and “asset segregation” in English).

c) **If the ESAs are to play a role in harmonising interpretations of financial regulation in the context of the CMU**, in no case should they give an interpretation of the texts that goes beyond the limits set by legislators at level 1, even on the pretext of ensuring a better protection of investors. Their intervention has in practice made difficult, and even in some cases impossible, the distribution to individual investors of collective investments in corporate securities or with a low liquidity because invested in the long term (infrastructures etc.).

d) **The ESAs should systematically condition access to the European market by players/products/services from third countries to the existence of regulations and implementing conditions at least as stringent as in the EU**. AFG therefore calls on ESMA and the EC to strictly implement the reciprocity principle in the context of their work on the AIFM third country passport. Only a strict application of the principle of reciprocity will allow preserving the high level of investor protection set by the EU.

19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

The danger here is to consider individual savers as deprived of critical sense, and for their own good to prevent them access to certain products, which is source of distress and results in practice in refusing them access to performing savings solutions, keeping the latter for institutional investors or wealthy individuals. Recent rules on suitability, complex to implement, appear maximalist. On the contrary, it would be appropriate not to create around the risk taking or return process a distressing environment, which would give incentives inconsistent with the objective of the CMU. **The calling into question of the funding of advice, the extensive concept of complex product, the existence in some countries of remuneration rates for administered savings and/or government guarantees for certain products, have in particular – unfortunately the list is not exhaustive – resulted in turning individual investors away from savings products which finance the economy and provide good returns. This may give a competitive advantage to index based products. This may also contribute, by channelling part of savings to products that mechanically create herd behaviour, to increasing systemic risk.**

Obviously a corollary is clear, precise, synthetic information understandable by individuals, in particular relating to the risk taken and the expected return.

Furthermore, provided they are accompanied by tax incentives, two methods of different nature and reach may contribute to increasing investment by individuals:

a) **Launch voluntary individual retirement savings products**. This would allow encouraging households to save in the long term. This would not mean harmonising national pension regimes but rather adding a complementary product with a pan-European dimension (29th regime).

b) **Create conditions for the generalisation in all European countries of company retirement savings plans, based in particular on employee/company savings funds**. This solution would not only cover the whole of the population but also have the advantage of allowing in the short-medium term the constitution of a sufficiently large amount of capital that could be invested in companies and the local economy.

Assuming a contribution rate corresponding in average to 1.5% of the gross payroll of the Eurozone countries (i.e. a rate corresponding to 8-10% of the retirement contributions existing today in the EU), the benefit of such a mechanism should be at least threefold:

- after 20 years, the reserves accumulated through the mechanism should be around 15% of the GDP,
- given the assumptions adopted on growth rate and return, over 20 years, the mechanism should allow raising funds worth between 2,500 and 3,000 billion Euros,
- Thus this type of project implemented in all the countries of the European Union should generate around its 3rd year of existence already as much investable capital as the amount announced in the Juncker Plan of 315 billion Euros.

20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

Opposing simplicity to complexity is a false debate involving many dangers. Thus, an equity fund hedged against particular market or exchange rate changes is allegedly "complex" (and in practice, difficult to sell) whereas all government securities are by definition "simple"!

Rather, the issue relates to the proper use of tools available to managers and the proper information of investors. A "simple" product is not necessarily less risky or more interesting or better suited to the needs of savers.

AFG suggests the Commission to reassess the consistency of the PRIIPs-IMD-MIFID frameworks which are in many instances detrimental to strictly regulated products such as UCITS. In the same way, many AIFs are absolutely not "complex" in a bad sense!

A good practice has been, in France, for market regulators, banks and insurance companies to define a common position on the manner of qualifying the complexity – or the absence of complexity - of products; such an approach could be followed at European level.

21) Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

In order to ensure the competitiveness of the EU at international level, the EC must work more closely with international financial regulatory bodies and act in a more coordinated way with them. In many areas (financing securities, indices used as benchmarks, prudential rules for insurers), the EU anticipated or went beyond the work of the international bodies (FSB, IOSCO, AISC)[2] or of its main partners (US, Brazil, Australia…). This dual approach created regulatory arbitrage opportunities

[2] More recently, the FSB/IOSCO recommendations on money market funds seem to have been completely altered, missing the objective of reducing the systemic risk of constant NAV MMFs and broadening the scope of variable NAV MMFs.

favourable to our competitors; even more so now that the EU is increasingly opening up to third country players (please refer in particular to the AIFM third country passport).

In this context and with the aim of preserving European players from unfair competition (through regulatory dumping), **we also call on the EC to implement the principle of reciprocity both in international trade negotiations and when considering opening up the European market to third countries**.

In this respect, AFG supports ESMA's initiative to make a detailed assessment on a country-by-country basis in the context of its advice to the Commission on AIFMD.

In order to ensure an appropriate level of competitiveness of the EU, the EC should consider recalibrating certain aspects of the European regulation (Solvency II), be vigilant on the definition of level 2 measures (e.g. MIFID II and research financing) and drop its projects which are in contradiction with the very idea of CMU and which will be detrimental to the competitiveness of the EU (e.g. EFTT).

Last, we call on the EC for a regulatory pause, which would allow assessing the texts adopted which impact financial services in order to ensure that certain provisions do not contravene the objectives of the CMU and are not detrimental to the competitiveness of the EU.

<u>22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?</u>

A first series of measures that can be taken consists in improving access conditions granted to European managers that wish to distribute their funds in certain third countries. In certain third countries such as Australia, Japan and South Korea, local authorities require a prior registration of funds domiciled in Europe which is not easy. A prior registration of European managers is as well required in some third countries, in particular in the United States, in Brazil and in Australia. Some third countries such as Japan took restrictive measures regarding the transparency of asset management companies that are not Japanese. In Australia, in South Korea and in Brazil, as well as in Switzerland, European managers have to hire a locally registered company to distribute their funds. Some third countries, in particular continental China and India, require European managers and funds to comply with a regime of quotas. India, Japan and South Korea put in place a fiscal regime that places European funds at disadvantage. Some third countries, in particular Brazil, India and the United States, fully prohibit the distribution of European funds.

In this context, AFG supports the inclusion of asset management in the scope of the negotiations for a commercial treaty between the European Union and the United States (TTIP). Such a treaty could constitute an opportunity for European players, removing regulatory barriers imposed by American authorities on European asset management companies which wish to distribute their products in the United States, and thus offer American clients the opportunity to invest in European funds. Moreover, the situation is very asymmetrical with regards management delegations.

Indeed, a European manager managing a European fund may delegate the management of its portfolio to an American manager with no obligation for the American manager to register within the EU. Conversely, an American manager may not delegate the management of an American fund to a European manager if the latter is not registered beforehand with the American authorities.

Beyond the registration procedure, the obligation to fully comply with the local regulation and the fact of being subject to two legal regimes represent a strong impediment to accessing the American market.

In practice, this means that European managers cannot easily manage American funds from the EU, while American managers can freely manage European funds from the United States through delegation arrangements.

The second series of measures that can be taken relates to improving the conditions of fund management by European managers in some third countries. In Australia and in the United States, a licence delivered by the local authorities is required to perform an activity of management as a European manager. Many third countries require European managers to have a local presence either through a local entity such as in Brazil, in South Korea and in Taiwan, or through the signature of a joint venture, for instance in India. Some third countries, in particular China, prohibit European managers to participate to the management of Chinese funds. Last, some third countries set some constraints on foreign investments in local funds, in particular in Brazil, India, Japan and the United States.

It should also be noted that managers may be required to fully comply with national third country regulations which may be different, or even contradictory, with those applying in the EU.

23) Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

Considering the difficulties encountered by new intermediaries (please refer to our response to question 6), we would also like to raise the EC's attention on the need to preserve the essential role played by banks with regards the activity of market-making. Through their activity of market-making, banks indeed provide a key service to less liquid markets such as bond markets.

In the context of the structural banking reform, it is therefore of the utmost importance to set a definition of market-making which is not too restrictive and which allows keeping this activity within banks. Transferring this activity to a subsidiary would on the contrary reduce market liquidity.

We would also like to recall our comments on question 2 on the need for a consolidated tape.

24) In your view, are there areas where the single rulebook remains insufficiently developed?

Significant progress has been made over the last few years, thanks in particular to the work of ESMA. However, a lot remains to be done.

One aspect relates to the location of asset management companies. For a real level playing field, Member States should implement the texts fairly and selective fiscal advantages should be truly banned, which is not the case. Furthermore, competition should not take the form of regulatory dumping, whose consequences may be extremely wide. A European supervisory authority, for example ESMA, should be able to supervise a proper regulatory harmonisation and impose sanctions if relevant. We would like to recall in this respect that Luxembourg requires in practice that Luxembourgish AIFMs are created by a local management company, which is in our opinion inconsistent with the text and the objective of the Directive. A single set of rules (and a single reporting mechanism) is one of the priorities (please refer to question 25).

25) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

Given the heterogeneity of the measures examined and the players considered in the context of the CMU, **it seems essential that each of the ESAs keeps its own specificity**. A one-size-fits-all approach which would result in ill designed or irrelevant measures should indeed be avoided (e.g. remuneration policy for asset managers and bank employees in the context of CRD IV).

In the context of the CMU, each ESA should ensure the implementation of a single rule book for the area it supervises. In this respect, the ESAs should ensure a **better harmonisation of the interpretation of their guidelines** among the 28 Member States through peer reviews, reinforced if required.

If the ESAs are to play a role in harmonising the interpretation of financial regulation in the context of the CMU, they cannot in any case set rules that should rather be at the level of a Directive or a Regulation. **The ESAs should indeed make sure that they comply with the limits of their mandate set at level 1 (counter-example: MIFID II delegated acts and in particular research financing).**

While taking into account the specificities of each sector, the ESAs should jointly ensure a level playing field for regulated products/services. This requires **reinforcing coordination** among the ESAs, which should also ensure consistency among their work (for example, the work on PRIIPs made in 2014 does not take into account the work on the KIID made by CESR).

European budgets and national regulators should provide the ESAs with sufficient means so that they can fully perform their important competences.

Regular consultation of the stakeholders could contribute to the success of the CMU; therefore AFG would like to highlight the importance of further improving the working methods of the ESAs, in particular:

- by setting consultation periods of sufficient length, which will allow them to have enough time for their own consultations,
- by pursuing the dialogue beyond consultations (reaction to responses…),
- by using stakeholder panels more efficiently.

Last, it seems relevant to **move up to ESA level the reporting regimes that currently are decentralised at the level of national regulators** (AIFM for example). However, a single reporting format should be established beforehand in order to facilitate the processing of data by the ESAs and to reduce administrative burdens for companies subject to reporting.

26) Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

The securities ownership chain should keep relying on the notion of right to property, which is a sound base of the continental securities law.

The EC aiming at finalising the CMU by 2019, it seems unrealistic to tackle questions 26 and 29 which would require a complete recast of the legal systems existing in the 28 Member States. Considering the failure of previous negotiations, we invite the EC to drop this line of approach.

27) What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border

Thanks to the Collateral Directive of 6th June 2002, our collateral regime is robust and stable (please refer to collateral management in the context of the Lehman Brothers case). Therefore **it does not seem necessary to propose new measures aiming at improving cross border flows of collateral.**

Regarding collective investment schemes (CIS), it is not necessary to publish a European regulation equivalent to that on the solvability of credit institutions. In case of a default of a CIS, texts regulating close-out netting are applicable. Therefore, there is not any improvement neither of the binding nature of collateral cross border nor of the closeout netting agreements to be expected for CIS.

The EU should nonetheless encourage the collateral admitted at the level of CCPs to be as wide as possible. In particular, the collateral admissible at CCPs should be limited neither by clearing brokers nor by other brokers in the chain (in case of a model of indirect clearing).

Furthermore, AFG is concerned by the FSB projects on automatic haircuts (on collateral in the context of securities financing transactions which would not go through a CCP) and by its potential consequences on the availability and liquidity of collateral in the EU. Haircuts should be decided upon by market players on a case-by-case basis and not in a systematic way. AFG would like to recall in this context that the absence of automatic haircut would be perfectly justified for UCITS and AIFs, which are allowed a 10% counterparty risk on a single entity.

28) What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them ?

In some EU countries, the exercise of voting rights is paved with difficulties for investors from other countries (power of attorney, share blocking mechanism, compulsory registration in the nominative form, specific non standardised voting forms) even though the preamble of the 2007 Shareholder Rights Directive promotes the facilitation of a cross border exercise of voting rights.

The efficiency of the transmission chain of votes at general assemblies should be improved by ensuring the modernisation of depository circuits and the development of electronic voting which facilitates the - necessary - existence of a receipt of the votes.

However, the Shareholders Right Directive currently under discussion should not result in practice in increasing constraints on shareholders (some provisions of the initial text and several amendments currently discussed at the European Parliament unfortunately go in that direction) and make it more difficult to reach the objectives of the CMU.

29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

Please refer to our response to question 26.

30) What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

AFG believes that the following two measures constitute (or would constitute) major barriers to the CMU:

- **the application of internal rates of withholding tax followed by the reimbursement of the excess paid over fiscal conventions. States should directly charge the conventional rate,**

- **a potential EFTT.**

An EFTT limited to 11 Member States would create a distortion of competition among participant States and other States, a fragmentation of the European capital markets and a relocation of financial services activities which would be to the detriment of the States participating to such an enhanced cooperation.

An EFTT applied by 28 Member States would also be as contradictory to the objectives of the CMU, as it would push financial activities to relocate outside the EU, increase the cost of capital market financing for companies, penalize investors and reduce market liquidity.

Moreover, if it were to apply both to fund units and their underlying securities (which is unfortunately provided for in the initial proposal of the Commission), the EFTT would not encourage individual investors to invest through investment funds, such as ELTIFs, UCITS or AIFs, as they would become more costly than direct investments. For this reason, the EFTT would create a bias in favour of products to which it does not apply, such as insurance contracts or savings accounts.

We therefore call on the European authorities to drop this project.

31) How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

AFG would like to raise the EC's attention on the need for more flexible State aid rules; in particular with regards the financing of innovative SMEs and the financing of companies at start-up and development stages (please refer to our response to question 1).

In the area of asset management, a greater use of new technologies should be facilitated by the regulation, in particular for the distribution and reporting to clients.

32) Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

Please refer to question 1.